



Ministry of Finance

Debt and Financial Assets  
Management Department

# The Czech Republic Funding and Debt Management Strategy

# 2020



20 December 2019



# **Ministry of Finance**

## **The Czech Republic Funding and Debt Management Strategy for 2020**

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Management Strategy for 2020**

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On 6 December 2019 the structure and method of covering the financing needs in the budget year 2020 were decided and the basic absolute and relative limits for issuance activity on the domestic and foreign markets and for active management of the state debt portfolio, financial assets and liquidity of the treasury single account in the individual currencies were approved (Ref. No. MF-31435/2019/2002-1).

This defined operational framework in the form of the submitted The Czech Republic Funding and Debt Management Strategy for 2020 enables the Ministry of Finance to act flexibly on the domestic and foreign financial markets while actively securing cash resources for covering the financing needs and ensuring the daily solvent position of the state, meaning the creation of initial conditions for smooth implementation of budget and fiscal policy of the government.

The Czech Republic Funding and Debt Management Strategy for 2020 is based on and is consistent with the State Budget Act of the Czech Republic for 2020, including the medium-term outlook to 2022, the Fiscal Outlook of the Czech Republic from November 2019 and the Macroeconomic Forecast of the Czech Republic from November 2019.

The Czech Republic Funding and Debt Management Strategy for 2020 is submitted via Debt and Financial Assets Management Department, which is responsible for operations related to the funding of the state, active management of the state debt portfolio and financial assets, management of the liquidity of the treasury single accounts, and short-term and long-term investment of available cash resources of state financial assets and the treasury single accounts on financial markets.

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## List of Abbreviations

bn	billion
CaR	Cost-at-Risk
CNB	Czech National Bank
CZK	Czech Koruna currency code
CZSO	Czech Statistical Office
EIB	European Investment Bank
ESA 2010	European System of Account 2010
EUR	Euro currency code
GDP	gross domestic product
JCR	Japan Credit Rating Agency
MoF	Ministry of Finance
MTS	Mercato Telematico Secondario
p.p.	percentage point
R&I	Rating and Investment Information, Inc.
T-Bills	state treasury bills
T-Bonds	medium-term and long-term government bonds

Published aggregate data in the tables and in the text may not correspond in the last decimal place to the sum of respective indicators due to rounding in some cases.





## Introduction

The Ministry of Finance (hereinafter the Ministry or MoF) presents to the public The Czech Republic Funding and Debt Management Strategy for 2020 (hereinafter the Strategy) in accordance with the calendar of published information, which contains a basic framework for the state funding for 2020 and sets limits and targets for each monitored state debt portfolio risk indicators in medium-term outlook.

Based on actual development of financing needs, state treasury liquidity management, and development of situation on financial markets in the first half of next year, the update of this Strategy will be published in June 2020. Ministry keeps the option to introduce quarterly updates of the Strategy within The Czech Republic Debt Management Quarterly

Report - 1<sup>st</sup> Quarter of 2020 and The Czech Republic Debt Management Quarterly Report - 1<sup>st</sup> - 3<sup>rd</sup> Quarter of 2020 for the purpose of most effective use of market conditions with a positive impacts on state budget.

The detailed description of events in the area of state debt, the evaluation of issuance, the analysis of secondary market of government bonds, the development of interest expenditure of the state budget, Cost-at-Risk model framework, the risk management of debt portfolio, and annual performance evaluation of primary dealers will be contained in The Czech Republic Debt Management Annual Report for 2019, which will be published on 14 February 2020.

## Key Events in 2020

### Financing Needs of CZK 271.1 Billion

- budgeted state deficit of CZK 40.0 billion
- redemptions of three CZK-denominated issues of medium-term and long-term government bonds in total nominal value of CZK 158.6 billion
- redemptions of three issues of savings government bonds in total nominal value of CZK 2.6 billion
- redemption of issue of EUR-denominated government bonds issued on foreign market in 2005 in total nominal value of EUR 1.0 billion
- development of treasury single accounts liquidity management with a focus on the assessment of the pilot phase of the term deposit project launched on 1 November 2019

### Primary Market of Government Bonds

- gross issue of CZK-denominated medium-term and long-term government bonds on domestic market in a minimum total nominal value of CZK 120.0 billion
- possibility of issuance of new benchmark issues of fixed-rate government bonds on domestic market with maturity from 2024
- development of market infrastructure for foreign currency-denominated government bonds issued under Czech law booked in the central register maintained by the Central Securities Depository Prague as discussed at the Users Committee held on 19 September 2019

- possibility of issuance of government bonds denominated in foreign currencies under foreign law in case of cost-favourable conditions
- stabilizing the number of benchmark issues of government bonds outstanding

### Secondary Market of Government Bonds

- fulfilment of quotation obligations through the MTS Czech Republic platform until 2021, which was determined and confirmed by a decision of the Primary Dealer Committee
- update of the structure of medium-term and long-term government bonds subjected to quoting obligations effective as from 1 January 2020
- continued tap sales and exchange operations of government bonds
- active support of the secondary market through medium-term and long-term government bonds lending facilities

### Direct Sale of Government Bonds to Citizens

- gradual electronization of the government bonds sale system to reduce distribution costs
- continuation of direct sale to citizens with supply of several types of government bonds
- possibility of subscribing at contractual distributors branches or via electronic access to asset account
- increase in the share of citizens holding state debt of the Czech Republic

## Rating of the Czech Republic

The Czech Republic belongs among the exceptionally reliable issuers and enjoys considerable interest from domestic and foreign investors, as confirmed by its high credit rating with a stable or positive outlook from all the major credit rating agencies with international scope of activity. The Czech Republic has the highest total rating of all the countries in Central and Eastern Europe and has had a higher rating than the Euro Area member countries average for several years.

In 2019, Moody's rating agency improved long-term credit rating from A1 to Aa3 with a stable outlook, appreciating the growing economy, sound public finances and strong institutional arrangements. In addition, ACRA Europe and ACRA have rated Czech Republic with AA- and AA grade respectively with a stable outlook, and existing ratings from S&P Global Ratings, Fitch Ratings and JCR have been affirmed.

**Table 1: The Czech Republic's Credit Rating in 2019**

Rating agency	Local currency liabilities	Outlook	Foreign currency liabilities	Outlook	Affirmed
Moody's	Aa3	Stable	Aa3	Stable	4/10/2019
S&P Global Ratings	AA	Stable	AA-	Stable	16/7/2019
Fitch Ratings	AA-	Stable	AA-	Stable	26/7/2019
JCR	AA	Stable	AA-	Stable	26/8/2019
R&I	AA-	Stable	AA-	Stable	5/11/2018
Scope Ratings	AA	Stable	AA	Stable	26/1/2018
Dagong Global Credit Rating	A+	Stable	A+	Stable	16/10/2018
ACRA Europe	AA-	Stable	AA-	Stable	26/7/2019
ACRA	AA	Stable	AA	Stable	23/10/2019

Source: Moody's, S&P Global Rating, Fitch Ratings, JCR, R&I, Scope Ratings, Dagong Global Credit Rating, ACRA Europe, ACRA

## Financing Needs and State Debt Development

The financing needs are determined by the standard components that must be covered by cash resources in a given year, i.e. the state budget cash deficit, and regular redemptions, early redemptions, and buy-backs and exchanges of nominal values (principals) of state debt, including the related derivatives.

Financing operations on the side of state financial assets and within the treasury single accounts then take place on the side of cash resources that can be involved into the covering of the financing needs simultaneously with the state's realized borrowing operations on financial markets.

**Table 2: Financing Needs**

CZK bn	2020F	2021F	2022F
State budget deficit <sup>1</sup>	40.0	40.0	40.0
T-Bonds denominated in local currency redemptions <sup>2</sup>	158.6	127.2	92.9
T-Bonds denominated in foreign currency redemptions <sup>3</sup>	26.0	52.0	71.5
Redemptions and early redemptions on savings government bonds	2.6	0.0	0.0
T-Bills and other money market instruments redemptions <sup>4</sup>	40.0	40.0	40.0
Repayments on credits and loans <sup>5</sup>	3.8	3.5	3.2
<b>Total financing needs</b>	<b>271.1</b>	<b>262.6</b>	<b>247.6</b>
<b>Total financing needs (% of GDP)<sup>6</sup></b>	<b>4.6%</b>	<b>4.3%</b>	<b>3.9%</b>

<sup>1</sup> For 2020 budgeted state budget deficit, for 2021 and 2022 medium-term outlook.

<sup>2</sup> Incl. the effect of already executed buy-backs and exchanges in previous years. Excl. future buy-backs and exchanges of T-Bonds.

<sup>3</sup> T-Bonds denominated in foreign currency redemptions are stated in CZK equivalent.

<sup>4</sup> Excl. T-Bills issued and redeemed within respective year and roll-over of other money market instruments.

<sup>5</sup> Credits and loans received from international financial institutions.

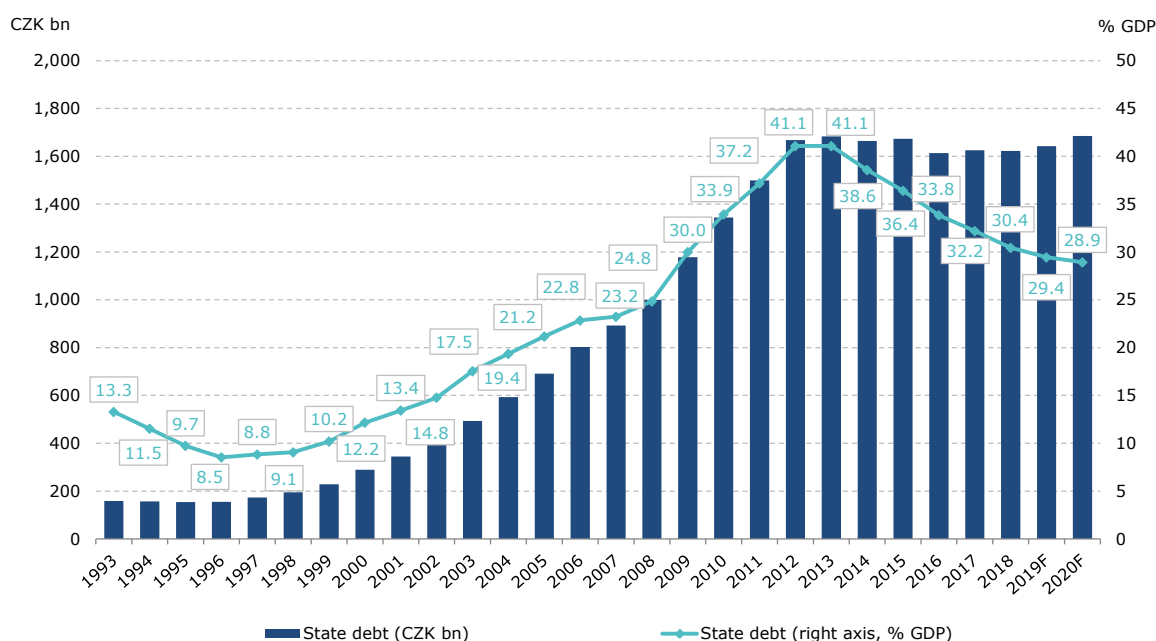
<sup>6</sup> Source for GDP in ESA 2010 methodology for 2020 to 2022 Macroeconomic Forecast of the Czech Republic – November 2019.

Source: MoF

For 2020, the planned financing needs amount to CZK 271.1 billion, i.e. about 4.6% of GDP, but its actual value will primarily depend on the actual state budget performance and on the actual amount of carried out exchange operations of government bonds in this year. In comparison with 2020 the planned financing needs in the following years will decrease by CZK 8 billion in 2021 and by CZK 23 billion in 2022 due to lower redemptions of medium-term and long-term government bonds denominated in local currency. State debt redemptions denominated in local currency in 2022 will be at the lowest level in the last ten years.

The resulting gross borrowing requirement, which is derived from the financing needs and represents the part of financing needs, which must be covered through borrowing operations on financial markets, especially government bond markets, is dependent on the involvement of financial assets into covering the financial needs, i.e. in particular the available state treasury resources. In case of involvement of these liquid assets into covering the financing needs, the resulting gross borrowing requirement is lower than total financing needs in respective period. In the opposite case, when there is an accumulation of financial assets, the gross borrowing requirement is higher than the financing needs.

**Figure 1: Czech Republic's State Debt Development**



Note: Source for GDP in ESA 2010 methodology for 1993 to 2018 is CZSO, for 2019 and 2020 Macroeconomic Forecast of the Czech Republic – November 2019. Source: MoF, CZSO

In recent years, the Ministry has focused on stabilizing the absolute value of state debt, resp. reducing its share in GDP. At the end of 2019 it is estimated to decline by 11.6 p.p. compared to the end of 2013. However, the final value will depend on the actual state budget performance, the financial market operations carried out at the end of this year and the level of GDP.

The Ministry plans to maintain the trend of decreasing state debt to GDP ratio in 2020, although the State Budget Act for next year shows an increase in absolute value of the state debt for approximately budgeted state deficit, i.e. CZK 40 billion. However, this is not the target value of the state debt, the final change will depend entirely on the issuance activity that the Ministry will flexibly adapt to the state budget performance, to the situation on domestic and foreign financial markets and to the effective involvement of the cash resources of public sector organizations' payment

accounts included in the treasury single accounts in order to smoothly cover the financing needs while maintaining a prudent approach to managing financial and credit risks and minimizing costs in the long-term horizon. However, these operative decisions will be transparently communicated with the public, particularly with the primary dealers and recognized dealers in government bonds, through regular updates of issuance calendars or alternatively through updates of issuance strategy in other publications of the Ministry.

Following the amendment to the Act No. 218/2000 Coll. on budgetary rules and on amendment to some related laws (budgetary rules), as amended from previous years, the Ministry will strive for continued centralization of the state liquidity management by extending numbers of clients included in the treasury single accounts and the related strengthening of liquid reserves of state debt financing.

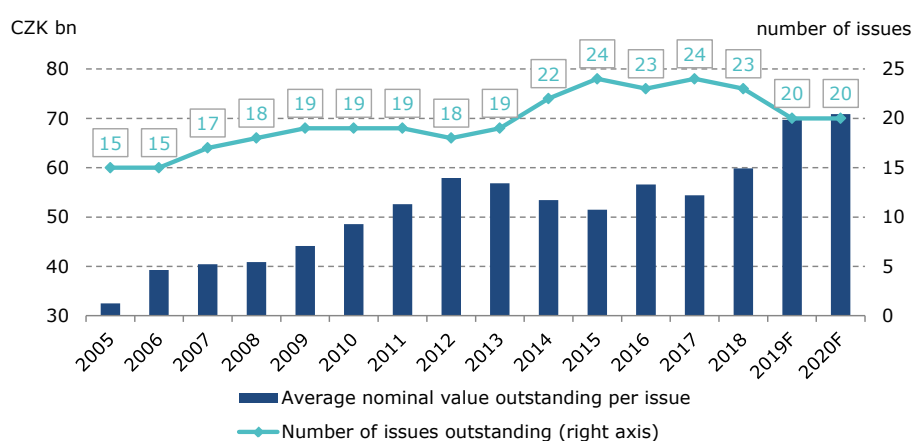
## Funding Programme and Issuance Activity

### Medium-Term and Long-Term Government Bonds

In 2020, the Ministry plans to carry out gross issue of CZK-denominated medium-term and long-term government bonds on domestic market in total minimum nominal value of CZK 120.0 billion. The Ministry will issue medium-term and long-term government bonds maturing along the whole yield curve in order to achieve the objectives and limits set in the Strategy for the medium-

term horizon. In dependence on the development on financial markets and the monetary policy situation, the Ministry plans to issue new issues of medium-term and long-term government bonds denominated in local currency with maturity from 2024. At the same time, the number of benchmark issues of CZK-denominated government bonds will be stabilized at the level of 20.

**Figure 2: Average Nominal Value of CZK-denominated T-Bonds per Issue**



Source: MoF

When choosing particular maturities and type of instrument, the Ministry will flexibly react on development of market conditions and the demand from the primary dealers and recognized dealers. The issuance including the inclusion of variable-rate

medium-term and long-term government bonds will be carried out with the respect to the riskiness of the debt portfolio and maintaining strategic targets and limits for risk parameters in medium-term horizon.

**Table 3: Framework Issuance Plan of T-Bonds on the Domestic Primary Market in 2020**

CZK bn	Framework scope of sale
<b>Fixed-rate and variable-rate T-Bonds</b>	Min. 120
Maturity segment of up to 10 years	Max. 150
Maturity segment of over to 10 years	Max. 180

Source: MoF

If there is an unexpected change of the Czech Republic's government bond market conditions during 2020, the Ministry reserves the option of not issuing new bonds. The Ministry also supplements the issuance of medium-term and long-term government bonds on the primary market with tap sales of medium-term and long-term government bonds from its own asset account on the secondary market in case that the primary dealers' and recognized dealers' interest in using these government bonds within medium-term and long-term government bonds lending facilities drops or as a more flexible alternative to the sale of government bonds, which are included in primary auctions to a lesser extent. Furthermore, tap sales of medium-term and long-term government bonds with a long time to maturity may be used to manage

the average time to maturity of the debt portfolio. Tap sales will continue to be available through MTS Czech Republic.

The competitive part of the primary auction of medium-term and long-term government bonds on domestic market will be held on the traditional auction day of Wednesday while the non-competitive part of primary auctions will be held on Thursday. The settlement will take place according to the T+2 standards for settling operations on the primary market, usually on Friday. The possibility to bid within the competitive part of the auction is made possible for both primary dealers and recognized dealers, but access to the non-competitive part of the auction remains exclusively to a group of primary dealers.

The issuance calendars of medium-term and long-term government bonds together with indicative maximum total nominal value sold in auctions for respective quarter of the year will be published monthly usually the third or fourth working Monday of the month preceding the respective month, unless otherwise announced. The Ministry reserves the right to specify one or more alternative medium-term and long-term government bonds to be included in the relevant auction or change the offered government bond for another one with a similar time to maturity. When choosing particular maturities and

instrument type, the Ministry will flexibly react to the development of market conditions and demand from primary dealers and recognized dealers.

The selection of particular medium-term and long-term government bonds for the relevant auction will be announced at least one working day before the date of the competitive part of the auction. The nominal value of medium-term and long-term government bonds offered in the competitive part of the auction will be published in indicative maximum amount or in indicative range within the issuance calendars.

## **Money Market Instruments and Other Debt Instruments**

In case of persisting interest rate differential, which now forms the difference between the auction yield of state treasury bills and the returns from investing liquidity of treasury single accounts, the Ministry is prepared to issue state treasury bills at all available maturities within one year during the year, in order to maximize the current situation in the market with regard to effective liquidity management of the treasury single accounts, and the funds thus obtained will not primarily be used to cover the financing needs, but will be further invested in the money market with a positive impact on the state budget.

State treasury bills will be issued on traditional auction day of Thursday with a T+1 settlement, usually on Friday.

The issuance calendars of state treasury bills with particular maturities offered in individual auctions will be published monthly usually on third or fourth working Monday of the month preceding the respective month unless announced otherwise by the Ministry. The nominal value of state treasury bills offered in auction will be published in predetermined indicative range or an indicative maximum value will be announced. However, the Ministry reserves the right to change the range or maximum value according to the actual development of market conditions or the demand from primary dealers and recognized dealers. Together with the issuance calendars, the Ministry will publish also the indicative maximum total nominal value of state treasury bills issues for respective quarter.

During 2020, the Ministry will also use the medium-term and long-term government bonds lending facilities intensively in the form of repo operations and also in the form of collateralized loans, under which the Ministry provides government bonds of Czech Republic from own asset account against another government bond or CNB bill for a short period of time. These facilities may be used for the period up to 90 days. The aim of these operations is to increase the liquidity of government bonds on secondary market particularly in case of short-term excess of demand over supply regarding the particular government bond. The scope of realized medium-term and long-term government bonds lending facilities will primarily depend of the demand for particular government bonds from the investors with the fact, that the Ministry will be ready to flexibly satisfy this demand accordingly to the availability of government bonds on its asset account.

If necessary, the Ministry plans to continue to benefit from favourable conditions on the money market for short-term refinancing of foreign currency liabilities of central government.

Funds may also be obtained from the European Investment Bank through the already signed loan contract, notably in the area of transport infrastructure and water management, or from other international institutions, if Ministry achieves cost-favourable conditions than in case of the issuance of government bonds on domestic market with a similar residual time to maturity.

## **Programme for Buy-Backs and Exchanges Operations on Secondary Market**

The Ministry plans the inclusion of government bonds into buy-backs and exchanges operations in dependence on market condition in particular segment of the yield curve and their execution will primarily depend on the demand from primary dealers. The exchange operations and buy-backs

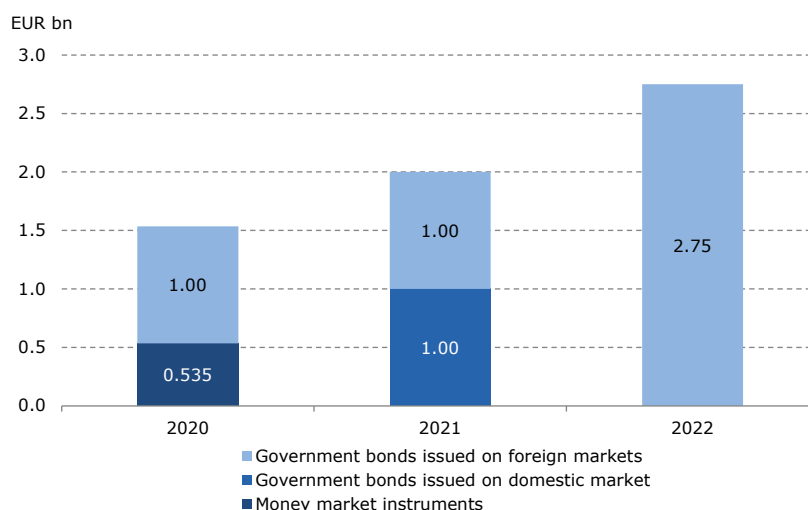
will be technically available through the MTS Czech Republic. The impacts of these operations will affect the financing needs and borrowing requirement accordingly and will have positive impact on refinancing risk of state debt management.

## Refinancing of Foreign Currency State Debt between 2020 and 2022

In the next three years, resources will be secured to cover the euro financing needs resulting from previous issuance activity on domestic and foreign markets for a total expected amount of EUR 6.285 billion, which represents the total unsecured euro exposure of government debt. This exposure consists of medium-term and long-term government bonds issued on foreign

markets between 2005 and 2012 in total nominal value of EUR 4.75 billion, short-term loans in the form of euro money market deposit operations of EUR 535 million and the Government EUR-Bond of the Czech Republic, 2019–2021, 0.00 % issued on domestic market in 2019 in total nominal value of EUR 1.0 billion.

**Figure 3: EUR-denominated Financing Needs between 2020 and 2022**



Source: MoF

In 2018, the Ministry partially covered the redemptions of medium-term and long-term government bonds issued on foreign markets by short-term loans on the euro money market in total nominal value of EUR 1.535 billion realized for negative yield. In 2019, a pilot issue of the Government EUR-Bond of the Czech Republic, 2019–2021, 0.00 % issued on domestic market under Czech law denominated in euro was successfully tested, when the nominal value outstanding has reached a target benchmark level of EUR 1.0 billion. This issue partially covered repayments of short-term loans on euro money market. Due to the management of the refinancing risk in foreign currency, the euro exposure was spread along the entire money market yield curve; therefore, the Ministry proceeded to sell the EUR-bond in connection with the repayments of individual deposit operations. All tranches of the EUR-bond and short-term loans were realized for negative yield by the Ministry, thus generating additional revenues to the state budget.

Given the developments in the euro bond market and the currently expected monetary policy of the European Central Bank, the Ministry may proceed with long-term refinancing of foreign currency debt next year. The specific coverage will be decided to minimize the costs and financial risks associated with borrowing operations on domestic and foreign financial markets.

In the case of maintaining favourable conditions in the form of negative or zero yields on the euro bond market and interest from primary dealers and recognized dealers, the Ministry plans to issue new issues of the EUR-bond on domestic market under Czech law for full or partial refinancing of euro financing needs and will continue to take further steps to develop and make this form of financing more attractive to international investors. As a new member of the Users Committee of the Central Securities Depository Prague, the Ministry initiated a connection to TARGET2 settlement system at its meeting on 19 September 2019, which is a first necessary step to make these government EUR-bonds an eligible assets in Eurosystem credit operations. This would mean a significant improvement in the development of the domestic capital market and its closer connection to the euro area bond market infrastructure.

The alternative in the form of syndicated issuance of medium-term and long-term government bonds on foreign markets under foreign law will depend primarily on actual conditions on domestic and foreign markets. A foreign issue is subject to lower interest expenses related to the issuance of government bonds on the foreign market compared to a comparable issue of government bonds on the domestic market, after taking into account additional costs in the form of fees for leading

managers of the issue, preparation of necessary documentation and other related activities.

Partial coverage of the euro financing needs may also be achieved through the use of short-term loans in

the form of deposit operations if the Ministry deems it appropriate with regard to the prudential approach to financial risk management and the minimization of interest expenditure.

## Direct Sale of Government Bonds to Citizens

At the end of 2018, the Ministry opened a direct distribution channel for government bonds for citizens offering a conservative and stable form of savings assessment, thus re-establishing the successful project of sale of savings government bonds intended for citizens and selected legal entities which was suspended in 2014 due to the fall in government bond yields to historical minimum. The Ministry allows households to participate in the financing of the government of the Czech Republic and to evaluate their savings under very similar conditions as institutional investors. After evaluating the pilot phase, which ended at the end of the first half of 2019, the Ministry decided to continue.

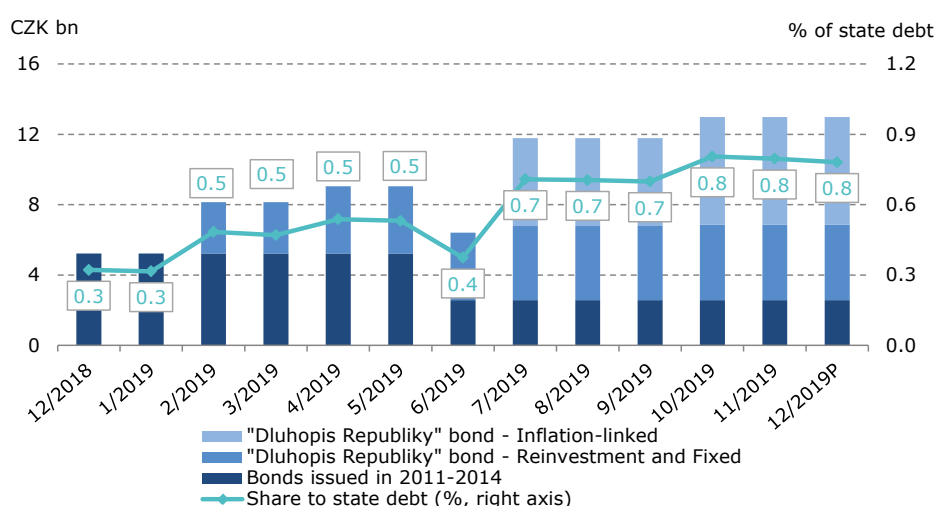
The Ministry considers the increase in the share of households in state debt to be desirable. Retail investors are usually conservative and not subject to short-term fluctuations in international bond markets, which contributes to greater stability and diversification of the investor base with a positive impact on the refinancing and interest rate risk of the debt portfolio. Holding government bonds for natural persons is advantageous even though they are mostly domestic entities and part of the interest

expenditure of the state debt service will generate additional income of domestic households.

During 2019, citizens purchased the "Dluhopis Republiky" bonds in total nominal value of CZK 10.4 billion as part of seven issues, while the Ministry offered to subscribe for 6-year reinvestment, inflation-linked and fixed government bonds. The yields of each issue of the "Dluhopis Republiky" bonds were set at the level of market conditions and thus do not burden the state budget more than the potential issue of medium-term and long-term government bonds with the same time to maturity. The bond yield will be reinvested after each interest period by subscribing additional government bonds on the relevant asset account in the Ministry's register in the amount of the bond yield after tax, according to the relevant legal regulations.

In 2019, the issues of the "Dluhopis Republiky" bonds covered the regular redemptions of savings government bonds issued in 2012 and 2014 in total nominal value of CZK 2.7 billion and significantly contributed to an increase in the share of government bonds intended for citizens in state debt from 0.3% at the end of 2018 to 0.8% at the end of 2019.

**Figure 4: Development of Government Bonds for Citizens Nominal Value Outstanding in 2019**



Source: MoF

As part of the continuation of the project, the Ministry plans to offer another issues of the "Dluhopis Republiky" bonds to citizens during the year 2020, while it will be possible to subscribe these bonds on a daily basis in the subscription periods, which will be continuously linked to each other. The bonds will be subscribed on the relevant asset account at the end of subscription period at quarterly intervals. It will be possible to subscribe all offered issues of the "Dluhopis Republiky" bonds via electronic access or through selected branches of contractual distributors Česká obchodní banka, a. s., and since November 2019 also Česká spořitelna, a.s.

One subscriber can subscribe bonds at a minimum of 1,000 pieces, i.e. CZK 1,000, up to 5,000,000 pieces, i.e. CZK 5 million. The subscriber may be only a natural person and in accordance with the terms and conditions the bonds are not freely marketable on regulated markets.

The aim of the Ministry is the gradual electronization of the sale system of distribution and administration of government bonds for citizens. During 2020, the Ministry plans to develop an electronic access to asset account management in order to improve existing functionalities, among to minimize the costs associated with the distribution of government bonds, and to expand it with other related services for citizens.

The decision of the Ministry was also endorsed by the Czech Fiscal Council on 5 December 2018 with its view that, in terms of the long-term sustainability of public finances and overall financial stability, the issuance of government bonds for citizens is considered as positive as this is not only an appropriate tool to mitigate risks from the point of view of the structure of the holders of state debt, but it also increases public awareness and public interest in the public sector economy.

## Strategic Targets, Limits and Risk Parameters of the Debt Portfolio

In connection with the sufficient liquidity of treasury single accounts and relatively stable balances of the accounts owners mandatorily included into treasury single accounts, improvement of the efficiency and modernization of state treasury liquidity management, the Ministry announces strategic targets and limits of refinancing and interest risk in medium-term horizon. This concept allows the Ministry to flexibly react on short-term market conditions and interest of investors for instruments in particular segment of time to maturity or re-fixing.

Short-term deviation from established strategic medium-term targets and limits for risk parameters of debt portfolio for refinancing and interest risk is possible. However, the issuance in medium-term horizon will be planned so that the targets and limits defined in this Strategy will be fulfilled in medium-term horizon.

For 2020, the Ministry maintains the concept of refinancing risk management through the average

### Refinancing Risk

The limit for the share of the short-term debt (debt due within 1 year) is stipulated at 20.0% of the total state debt for the medium-term horizon. The limit for the share of the medium-term debt (debt due within 5 year) is stipulated at 70.0% of the total state

time to maturity of state debt indicator and interest risk management through the average time to re-fixing of the state debt indicator using a medium-term target value of this indicator. This leaves the Ministry space for a possible flexible response to sudden developments on the financial markets.

The currency risk is specified by the net foreign-currency exposure of state debt indicator taking into account also the foreign-currency exposure of state financial assets. In this context, net foreign-currency exposure of state debt with the impact on state debt level and net foreign-currency exposure with the impact of the level of interest expenditure on state debt service are distinguished. The limit is stipulated for both indicators and is valid for each year of medium-term horizon without the possibility to exceed it. However, its value is subjected to the condition that there will be no sharp depreciation of Czech Koruna exchange rate. Compared to the refinancing and interest risk, the currency risk is relatively small.

debt for the medium-term horizon. For average time to maturity of the state debt, the target value of 6.0 years is stipulated for the medium-term horizon with the possibility of deviation of 0.25 years.



## Interest Risk

For interest re-fixing of the debt portfolio within 1 year, the limit at 40.0% of the total state debt is set for the medium-term horizon since 2020. For average time to re-fixing of the state debt, the target value of 5.0 years with the possibility of deviation of 0.25 years is stipulated for the medium-term horizon. The Ministry changed the target band to an upper limit due to the extension of

the average time to maturity of the state debt to the target value of 6.0 years. Another reason is the revision of the approach of variable interest rate debt instruments issuance which would not be cost-effective in a situation of higher reference rates in relation to the yield curve of fixed-rate government bonds.

## Currency Risk

For 2020, the Ministry retains the limit for both net foreign-currency exposure of the state debt indicators, i.e. net foreign-currency exposure of state debt with the impact on state debt level and

net foreign-currency exposure with the impact of the level of interest expenditure on state debt service, at the level of 15.0% (up to 17.0% in the short-term) of total state debt.

## State Debt Service Expenditure and Cost-at-Risk

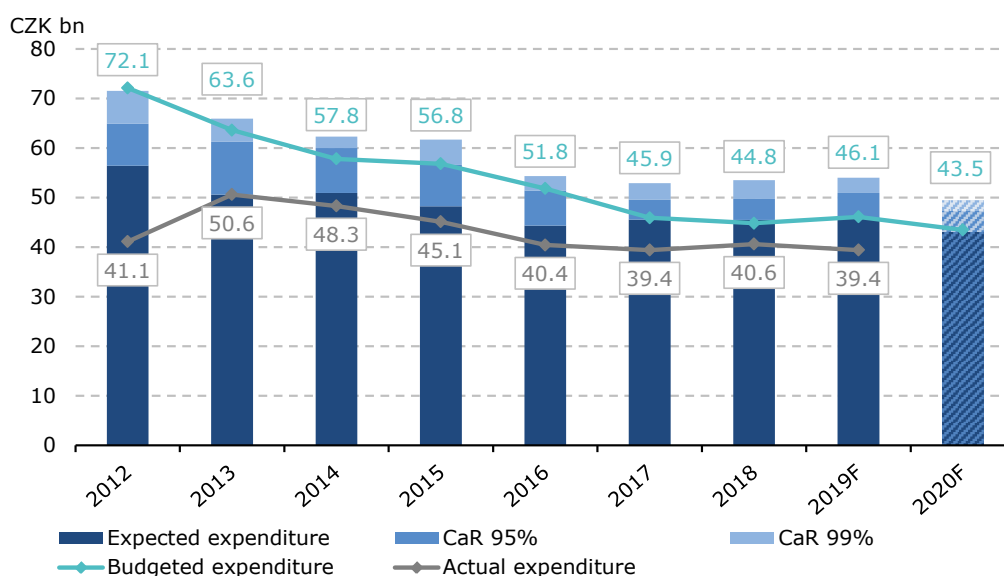
The Ministry applies a model framework known as Cost-at-Risk (furthermore CaR) for measuring and managing interest rate risk since 2005. This framework is based on the Value-at-Risk methodology and simulates future expected and maximum interest expenditure for a particular degree of risk, which is derived from the volatility of the time structure of interest rates. The stochastic element of the CaR model is the yield curve, and the deterministic element is the dynamic structure of the portfolio of state debt, which is based on the base case scenario of the funding programme while respecting the set strategic goals for managing financial risks.

The primary goal of the model is to determine the maximum interest expenditure on state debt,

which with 95% or 99% probability will not be exceeded (furthermore CaR 95% and CaR 99%). The secondary goal of the model is to estimate the actual interest expenditure on state debt. The simulation framework operates separately with the interest expenditure and interest revenue. The outcome of aggregation of interest expenditure and interest revenue is the net interest expenditure on state debt. Interest expenditure on state debt service in the model framework does not include fees related to state debt service, which are of a deterministic nature.

Over all the years the CaR methodology has been applied, the model has fulfilled the primary goal, since the simulated maximum interest expenditures were not exceeded in any of those years.

**Figure 5: Net Interest Expenditure and Cost-at-Risk**



Note: In 2012 to 2020, the figures represent the originally approved budget. Figure in 2019 is expected value.  
Source: MoF

**Table 4: Net Interest Expenditure and Cost-at-Risk**

CZK bn	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
<b>Budgeted expenditure<sup>1</sup></b>	72.1	63.6	57.8	56.8	51.8	45.9	44.8	46.1	43.5	46.1	49.8
<b>Actual expenditure<sup>2</sup></b>	41.1	50.6	48.3	45.1	40.4	39.4	40.6	39.4	-	-	-
<b>Expected expenditure</b>	56.4	50.6	50.9	48.2	44.3	45.6	45.5	45.8	43.1	45.8	49.6
<b>CaR 95%</b>	64.9	61.3	60.0	56.6	51.4	49.6	49.7	50.9	47.4	53.0	60.4
<b>CaR 99%</b>	71.5	65.9	62.3	61.7	54.3	52.9	53.5	54.0	49.4	57.5	68.1

<sup>1</sup> For 2012 to 2020 the figures represent the originally approved budget. In 2021 and 2022 medium-term outlook.

<sup>2</sup> Figure in 2019 is expected value.

Source: MoF

The expected value of net interest expenditure in 2020 amounts to CZK 43.1 billion. The expected value of net interest expenditure amounts to CZK 45.8 billion in 2021 and CZK 49.6 billion in 2022, which is given primarily by the use of less conservative model for risk premium on government bonds. In medium-term outlook of state budget for 2021 and 2022, the expenditure frameworks of budget chapter 396 - State Debt are below CaR 95% indicator. For 2021 the expenditure framework amounts to CZK 46.1 billion and is CZK 6.9 billion lower than 95% percentile of interest expenditure. For 2022 the expenditure framework amounts to CZK 49.8 billion and is CZK 10.6 billion lower than 95% percentile of interest expenditure. The increasing trend of budgeted and simulated

interest expenditure is given primarily by the volatility of interest rates, which increases with longer simulation horizon. Due to the fact that the state budget is compiled only for the following year, the simulation horizon of interest expenditure for the budget compilation for following year will be shorter, and given the market conditions remain unchanged, it is expected, that the values of CaR 95% and CaR 99% indicator will decrease due to the lower volatility of the interest rates simulations.

More detailed quantification of interest expenditure on state debt service in 2020 and in medium-term horizon through application of CaR methodology will be a part of The Czech Republic Government Debt Management Annual Report for 2019.

## Primary Dealers in Czech Republic Government Bonds

As of 1 January 2020, Raiffeisen Bank International AG is going to become a new primary dealer and expand the primary dealer group. Goldman Sachs International remains recognized dealer of Czech government bonds for 2020.

For the year 2020, the number of primary dealers who signed the Primary Dealer Agreement for Czech Government Securities with the Ministry is 9. Their list is content of the following table.

**Table 5: List of Primary Dealers in Czech Republic Government Bonds for 2020**

Primary Dealers	
Raiffeisen Bank International AG	Citibank Europe plc
KBC Bank NV / Československá obchodní banka, a. s.	J.P. Morgan Securities plc
Erste Group Bank AG / Česká spořitelna, a.s.	UniCredit Bank Czech Republic and Slovakia, a.s.
PPF banka a.s.	ING Bank N.V.
Société Générale / Komerční banka, a.s.	

Source: MoF

# Calendar of Information Published in the First Half of 2020

## January

Mo	Tu	We	Th	Fr	Sa	Su
		1	2	3	4	5
6	7	8	9	10	11	12
13	14	15	16	17	18	19
20	21	22	23	24	25	26
27	28	29	30	31		

## February

Mo	Tu	We	Th	Fr	Sa	Su
					1	2
3	4	5	6	7	8	9
10	11	12	13	14	15	16
17	18	19	20	21	22	23
24	25	26	27	28	29	

## March

Mo	Tu	We	Th	Fr	Sa	Su
						1
2	3	4	5	6	7	8
9	10	11	12	13	14	15
16	17	18	19	20	21	22
23	24	25	26	27	28	29
30	31					

## April

Mo	Tu	We	Th	Fr	Sa	Su
		1	2	3	4	5
6	7	8	9	10	11	12
13	14	15	16	17	18	19
20	21	22	23	24	25	26
27	28	29	30			

## May

Mo	Tu	We	Th	Fr	Sa	Su
				1	2	3
4	5	6	7	8	9	10
11	12	13	14	15	16	17
18	19	20	21	22	23	24
25	26	27	28	29	30	31

## June

Mo	Tu	We	Th	Fr	Sa	Su
1	2	3	4	5	6	7
8	9	10	11	12	13	14
15	16	17	18	19	20	21
22	23	24	25	26	27	28
29	30					

- Publication of the The Czech Republic Debt Management Annual Report for 2019  
- on the second Friday in February
- Expected publication of The Czech Republic Funding and Debt Management Strategy for 2020 - Second Half Update  
- on the last Friday of the first half of 2020
- Publication of The Czech Republic Debt Management Quarterly Report  
- on the third Friday in April
- Publication of statistics of the Central Government Debt and Fiscal Data for the Czech Republic (SDDS Plus standard)  
- on the second Friday in February and on the third Friday in April
- Publication of the annual statistics on Development and Structure of the State Debt, Financing Needs and Sources of the Central Government and Interest Expenditure on the State Debt  
- on the second Friday in February
- Publication of the Statistics on Government Bonds by Type of Instrument, Statistics on Government Bonds by Type of Holder and Statistics on Government Bonds by Maturity  
- on the last working day of the month
- Publication of the issuance calendars of T-Bills and T-Bonds for following month  
- the third or fourth Monday in the month prior to the month of the respective auctions, except June, when issuance calendar will be published together with The Czech Republic Funding and Debt Management Strategy for 2020 - Second Half Update

Ministry reserves the right to change the date of publication due to flexible response to financial markets situation. Any change will be communicated to the public in time through Ministry's website.

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The publication was prepared based on the information and data available on 20 December 2019. The Ministry reserves the right to promptly respond to the actual development of financing needs using its tools in the course of 2020. The fulfilment of the funding programme and announced strategic goals will depend of the development of the situation on domestic and foreign financial markets in terms of the minimization of expenditure on state debt service and financial risk management.

This publication is also available on the following website:

[www.mfcr.cz/statedebt](http://www.mfcr.cz/statedebt)

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